Supreme Court, U.S.
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IN THE SUPREME COURT
OF THE UNITED STATES

October Term 1994

ISIDOR FRIEDMAN
DOROTHY FRIEDMAN
Petitioners

vs.

PHILIP C. GRACE AND
DAVID A. SIEGEL
Respondents.

PETITION FOR WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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38 pp

Questions Presented

1. Does a Bankruptcy Court have the authority to decide an essential element existed concerning dischargeability when the U.S. Supreme Court has decided otherwise?

2. Is it a denial of due process to not allow a Debtor the benefit from a change in a Bankruptcy statute?

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Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit filed January 27, 1995.

OPINION AND ORDERS BELOW

The opinion of the United States

Court of Appeals for the Ninth Circuit was ordered by that court not to be published and is reproduced in Appendix A, infra.

JURISDICTION

The opinion of the United States Court of Appeals for the Ninth Circuit was filed on January 27, 1995. This petition was timely filed within ninety (90) days of that date. 28 U.S.C. §2101 (C); S.Ct.R. 13.1. The jurisdiction of this Court to review the judgment of the United States Court of Appeals for the Ninth Circuit by writ of certiorari is conferred by 28 U.S.C. §1257 (a).

CONSTITUTIONAL PROVISION INVOLVED

The due process clause of the 14th Amendment to the United States Constitution provides in pertinent part:

"... nor shall any state deprive any person of... property, without due process of law... "

STATEMENT OF THE CASE

On October 30, 1981, Respondents obtained a judgment against Appellants in the Central District of California in the amount of $1,406,453.88. On October 26, 1987, this debt was found non-dischargeable in a prior bankruptcy case filed by Appellants, Case No. 69-736-BR. This judgment was granted under the provision of Section 17(a) (2) of the Bankruptcy Act [formerly 11 U.S.C. 35(a)(2)]. These provisions did not include "reasonable reliance" as an essential element to a finding of non-dischargeability for fraud.

Respondents presented evidence in this first non-dischargeability case that Appellant Isidor Friedman had

signed a guarantee for a loan listing a net worth of $2.3 million but had failed to disclose he was in a Chapter 11. Respondent's evidence showed that Respondents had first refused to make the loan on the basis of Appellant's guarantee alone - but then did make the loan when Appellant brought in Robert McCulloch, whom Respondents described as "extremely strong financially".

Respondent Philip Grace testified in this first non-dischargeability proceeding that he relied and reasonably relied on Appellants' guarantee and would not have made the loan without guarantees of both Mr. McCulloch and Mr. Friedman. Appellant represented himself in the first non-dischargeability case. These facts were presented to the United States Court of Appeals for the Ninth Circuit.

On July 11, 1990, the Appellants

filed the above-entitled Chapter 7. Respondents filed a Complaint to determine the above debt to be non-dischargeable. In this Complaint, Respondents alleged that the above Judgment of Judge Russell in the prior bankruptcy was "res Judicata" on the matter.

Appellants answered.

Respondents filed a Motion for Summary Judgment on April 15, 1992, alleging that Judge Russell had made a finding of "reasonable reliance". Respondents argued that this finding made Judge Russell's Order "res judicata" despite the fact that the old statute under which the case had been tried did not require adjudication of the question of reasonable reliance.

Appellants asserted that the lack of the element of "reasonable reliance" in the old statute deprived the prior

Order of any "res judicata" effect.

The Bankruptcy Court in the above-entitled bankruptcy agreed with Respondents and granted summary judgment.

Appellants filed an appeal to the Bankruptcy Appellate Panel. That Panel issued a ruling for Respondent on the same basis as the opinion of the Ninth Circuit. Appellants filed an appeal to the United Court of Appeals for the Ninth Circuit.

It is from the opinion of the Ninth Circuit that Appellants now appeal (Appendix A).

A. Presentation and Decision of the Federal Constitutional Questions.

The same argument as is being made here was made to the lower Courts – i.e., that a decision under the prior law Section 17a of the Bankruptcy Code, is not "res judicata" under 11 U.S.C.

523 of the new Bankruptcy Code.

Although the term "due process" was not explicitly used – all arguments concerning "res judicata" are due process arguments and are recognized as such.

When "res judicata" is applied, a person is denied a (further) hearing or trial; when it is improperly applied a person in unfairly denied a hearing and denied due process.

REASONS THE WRIT SHOULD BE GRANTED

I.

THIS COURT SHOULD GRANT THE WRIT TO CLARIFY A MISCONCEPTION APPARENTLY PREVALENT IN THE INFERIOR COURTS AS TO THE APPLICATION OF "RES JUDICATA"

Both the Bankruptcy Appellate Panel and the Appellate Court misapplied the Doctrine of "res

judicata" to mean "actually litigated" instead of its true meaning, "necessary to the decision". (See "Argument" for further discussion).

This erosion of the strict meaning of the doctrine of "res judicata" resulted in a denial of due process in the case at Bench and likely will result in a similar denial in the future. (See "Argument" for further discussion).

II.

BECAUSE THE NINTH CIRCUIT AND THE BANKRUPTCY COURT APPLIED INFERIOR COURT RULINGS INSTEAD OF A CONTRARY UNITED STATES SUPREME COURT RULING AND A CONTRARY STATUTE THIS COURT SHOULD GRANT THIS WRIT TO EXERCISE ITS SUPERVISORY AUTHORITY.

(See "Argument" for further discussion).

ARGUMENT

I.

THIS COURT MAY REVIEW AN OPINION OF A LOWER FEDERAL COURT WHICH IGNORES ESTABLISHED JUDICIAL NORMS.

This Court's Rule 10 states as an important consideration for granting a writ of certiorari, the need to supervise Court of Appeal (Federal) which vary significantly from judicial norms.

II.

THE LOWER COURTS ARE INCORRECT – PRIOR TO THE NEW LAW COURTS WERE NOT CONSISTENT IN REQUIRING REASONABLE RELIANCE – THE UNITED STATES SUPREME COURT AND MANY OTHERS DID NOT REQUIRE IT.

Petitioners' argument was (and is) that the element of "reasonable reliance" was not a required element at the time of the first bankruptcy decision of non-dischargeability and so

that Judgment should not have been given "res judicata" effect in the second bankruptcy after the law changed and this element was added. See Section II, infra.

The Ninth Circuit stated,

> "Courts interpreting section 17a(2) have consistently read into the statute a requirement that a creditor's reliance be reasonable". Appendix A.

This is untrue. The only United States Supreme Court case on the subject Gerdes v. Lustgarten (1924) 45 S.Ct.107; 266 U.S. 321 did not require "reasonable reliance".

> "We think that these two cases embody, in substance, the rule that should be here applied. Under the Bankruptcy Act the

> discharge is to be denied if it is shown that the bankrupt 'obtained money or property on credit upon a materially false statement in writing, made by him... for the purpose of obtaining credit.' The only essentials to the statutory bar, in so far as relates to the present question, are: (a) That the written statement was made for the purpose of obtaining credit; (b) that it was materially false; and (c) that the credit was obtained upon it."

Gerdes v. Lustgarten (1924) 266 U.S. 321-326.

This Court listed the elements for non-dischargeability and did not list

reasonable reliance as an element.

Other courts interpreting Gerdes v. Lustgarten, supra, felt the Supreme Court was not requiring reliance.

> "It is clear from the language of the statute that the purpose of Congress was to prevent any person from falsifying in writing his financial condition and thereby obtaining money or property on credit, or an extension or renewal of credit without suffering the consequential penalty of being denied the privilege of discharging his debts in bankruptcy. The objective was to prevent benefit from fraud or fraudulent falsification in commercial

> or any other sort of business transactions. A court of equity in protecting the rights of all creditors of a bankrupt will not shield dishonesty. The technical argument made here that the party objecting to the discharge had knowledge that the fraudulent misrepresentation in writing was untrue or even connived with the bankrupt should not be seriously considered."

Cunningham v. Elco Distributors (6th cir. 1951) 189 F.2d 87, 89 which cited Gerdes, supra, as authority for the above.

Or see, Matter of Garmen (1980) 643 F.2d 1252, 1259 where Gerdes, supra is

quoted (same passage as here). The Court in Garmen states:

> "The present issue for the court is simply whether the bankrupt obtained credit, or a renewal, through the creditor's reliance on a materially false financial statement containing information apparently sufficient to obtain an accurate picture of the debtor's financial condition with regard to a reasonable decisional factor in the loan decision, filed by the debtor with the intent to deceive the creditor. The creditor need establish only its reliance in fact, although its claims to

> reliance cannot be so unreasonable as to defeat a finding of reliance in fact."

Garmen, supra, at 1258. Only reliance in fact is needed – not reasonable reliance.

The case of In re Culp (BK N.D. Okla. 1992) gives a good history of the element of "reasonable reliance" and non-dischargeability as the following quote shows. While the Supreme Court only required actual reliance the lower courts in many cases were only playing "lip service" to the requirement of "reasonable reliance".

> "One group simply inquired whether a creditor actually relied on a debtor's false representations, e.g. In re Kaplan, 141 F.463 (E.D.Pa.1905), In re Jaffe,

20 F.2d 370 (2nd Circ. 1927), International Shoe Co. v. Kahn, 22 F.2d 131 (4th Circ. 1927), In re Hochberg, 17 F.Supp.916 (W.D. Penn. 1936), In re Livermore, 96 F.2d 93 (2nd Circl 1938) Crue v. Timmer, 119 F.2d 415 (6th Circ. 1941), Eline v. Richard, 296 Ky. 283, 176 S.W. 2d 697 (1943), reh. den. 1944), In re Savarese, 56 F. Supp. 927 (E.D.N.Y. 1944), Banks v. Siegel, 181 F.2d 309 (4th Circ. 1950), Rustuen v. Apro, 40 Wash.2d 395, 243 P.2d 479 (1952), Industrial Bank of Commerce v. Bissel, 219 F.2d 624 (2nd Circl 1955), In re Freeman, 131 F. Supp. 437

(S.D. Cal. 1955), M-A-C Loan Plan, Inc. v. Crane, 4 Conn. Cir. 29, 225 A.2d 33 (1966).

The U.S. Supreme Court directed lower courts to concentrate on the reality rather than the propriety of reliance. In Gerdes v. Lustgarten, 266 U.S. 321, 326, 45 S.Ct.107, 109, 69 L.Ed.309, 312 (1924), the Supreme Court held that, where a debtor had succeeded in misleading a creditor by inducing actual reliance upon a false statement, 'it does not lie in his mouth to say that, by reason of extrinsic circumstances, the creditor was not justified in

relying upon it.' The Supreme Court's directive was followed by the Court of Appeals of this Circuit, which treated reliance simply as a matter of 'proximate result' or 'actual ... effect' ..., Mullen v. First Nat'l Bank of Ardmore, Okl., 57 F.2d 711, 712, 713 (10th Circ. 1932), or 'proximate cause,' 407 F.2d 16, 19 (10th Circ. 1969); and see In re Vickers, 577 F.2d 683, 687 (10th Circ. 1978). A fourth group of cases neglected the Supreme Court's ruling in Gerdes v. Lustgarten, and continued to speak of 'reasonable' as distinct from 'actual'

reliance, though in terms that were ambiguous, confusing and perhaps confused, e.g. In re Matera, 436 F.Supp.947 (E.D. Wis. 1977), In re Smith, 424 F. Supp. 858 (M.D. La. 1976), Kentile Floors, Inc. v. Winham, 440 F.2d 1128 (9th Circ. 1971). A line of cases developed in the 7th Circuit which gave lip service to a separate requirement of "reasonableness', yet applied it in such a way that it amounted to nothing more than the usual requirement of actual reliance, Carini v. Matera, 592 F.2d 378 (7th Circ. 1979), In re Garman, 643 F.

2d 1252 (7th Circ. 1980), cert. den. 450 U.S. 910, 101 S.Ct. 1347, 67 L.Ed.2d 333 (1981).

In Re Culp (BK. N.D. Okla. 1992), 140 B.R. 1005, 1010-1012.

III.

THE FIRST BANKRUPTCY PRIOR ORDER WAS NOT ENTITLED TO BE GIVEN RES JUDICATA (OR ISSUE PRECLUSION) EFFECT.

For res judicata or the related doctrine of issue preclusion, the following elements must apply:

(1) The issue at stake is identical to that involved in the prior litigation;

(2) The issue was actually litigated in the prior litigation;

(3) The issue was determined by valid and final judgment;

(4) The determination of the issue in the prior litigation was

essential to the judgment in the earlier action;

(5) The standard of proof in the prior litigation was at last as high as in the present litigation. Spilman v. Harley, 656 F.2d 224, 228 (6th Cir. 1981).

In the case at Bench, Item No. 4 does not apply. A finding of "reasonable reliance" was not necessary to the first non-dischargeability Order, even though the Judge made such a finding. Appellants did not have the incentive to fully litigate this issue as it was not an essential element to a judgment under the prior bankruptcy statutes.

Because the Respondents did not make the loan in question based on only Appellants' guarantee, but waited until Appellants had brought in a new investor, described as "extremely

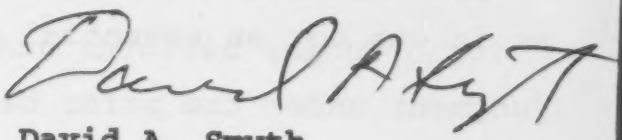
strong" by Respondents, it seems that Appellants should have been allowed to benefit from the change in the law concerning "reliance" by lenders.

CONCLUSION

This Court should grant review to exercise its supervisory function.

The lower courts clearly misstated the state of the law regarding non-dischargeability prior to 1978 and ignored controlling U.S. Supreme Court precedent.

Respectfully submitted,



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